

February 2026

Updates to State-Directed Payments Policy

Overview

As key parts of the 2024 Managed Care Final Rule and H.R.1 come into effect, there are numerous changes to state-directed payment (SDP) policy to keep in mind while planning for upcoming rating periods. These changes could involve the SDP structure, as well as updates to capitation rate development, if necessary.

H.R. 1 Requirements Impacting SDPs

Payment rate changes

The legislation directs the Secretary to update the rules for SDPs for inpatient services, outpatient services, nursing facility services, and physician services at Academic Medical Centers, limiting the total payment rate for specific services to:

- 100% of the published Medicare payment rate for expansion states (or, if no specific Medicare rate is available, the Medicaid State Plan rate).
- 110% of the published Medicare payment rate for non-expansion states (or, if no specific Medicare rate is available, the Medicaid State Plan rate).

However, it is not clear what methodology CMS will require states to use to develop the new Medicare-based limits for SDP payments.

Grandfathering of certain payments

SDP preprints that 1) were submitted or approved prior to July 4, 2025 and 2) for a rating cycle within 180 days of July 4, 2025 can be "grandfathered" in. This means that total payment levels to providers are frozen at the amount included in calendar year (CY) 2024, state fiscal year (SFY) 2025, CY 2025, SFY 2026, or CY 2026 preprints. For these payments,

- The total payment amount will be gradually reduced by 10 percentage points each year starting January 1, 2028;
- Until the payment rate aligns with the new limits (either 100% or 110% of Medicare, depending on the state).

Provider taxes frozen

Provider taxes are often the source of the non-federal share of SDPs. H.R.1 places a moratorium on new or increased provider taxes as of October 1, 2026 beyond the levels that were enacted and imposed as of July 4, 2025. CMS released guidance on their current interpretation of “enacted” and “imposed” in a letter dated November 14, 2025, but further clarification is expected through rule making. States who fund their SDPs through provider taxes will need to understand the maximum collection amounts starting October 1, 2026, to determine if changes are necessary to their SDPs. Expansion states must follow the tax collection phase-down schedule if they are collecting taxes above 3.5% of provider revenues starting October 1, 2027.

2024 Managed Care Rule Requirements Impacting SDPs

Prohibition on Retroactive Changes to SDP Preprints – *Effective for Rating Periods Starting October 1, 2026; January 1, 2027; and July 1, 2027*

States will no longer be permitted to submit retroactive changes to SDP preprints to adjust provider payment levels or total fiscal impact. Federal regulations (42 CFR § 438.6(c)(2)(viii)) require states to submit complete preprints or amendments, including all required documentation, prior to the start date of the preprint or amendment. This change affects states that previously used retroactive preprints to accommodate variable payment terms or utilization exceeding expectations.

Managed Care Contract Requirements – *Effective for Rating Periods Starting October 1, 2026; January 1, 2027; and July 1, 2027*

States must include detailed descriptions of every SDP in managed care contracts, as required by 42 CFR § 438.6(c)(5)(i)-(iv). Required contract elements include a description of the provider class, a description of the payment arrangement, including fee schedules, uniform increases, and performance measures, CPT or other claim codes linked to payment, and several other items.

For More Information

Please contact Dianne Heffron, Debbie Anderson, Charlie Greenberg, or your Mercer consultant to discuss the potential impact your specific state Program. You may also email us at: mercergovernment@mercerc.com.

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